

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-1342

To be argued by
DAVID A. CUTNER

United States Court of Appeals FOR THE SECOND CIRCUIT

Docket No. 77-1342

UNITED STATES OF AMERICA,

Appellant,

—v.—

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN,
PETER S. DAVIS, ALAN E. SANDBERG, and
ERIC BERGE,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR THE UNITED STATES OF AMERICA

ROBERT B. FISKE, JR.,
*United States Attorney for the
Southern District of New York,
Attorney for the United States
of America.*

DAVID A. CUTNER,
FREDERICK T. DAVIS,
LAWRENCE B. PEDOWITZ,
*Assistant United States Attorneys,
Of Counsel.*

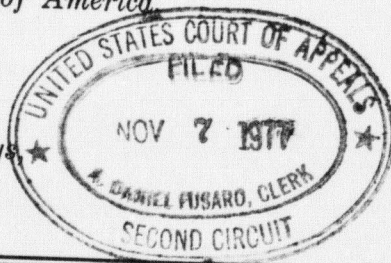


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REPLY BRIEF FOR THE UNITED STATES OF AMERICA

Preliminary Statement

In this appeal, the Government seeks a reversal of the District Court's decision to dismiss most of the counts and allegations of the Indictment because of the SEC's misconduct in a prior related civil proceeding. The Government's initial brief demonstrated that, in fashioning its "equitable" remedy, the District Court ignored and violated virtually all of the principles governing the granting of equitable relief.

Predictably, the defendants have spent little time responding to the Government's arguments. Instead, they raise a variety of claims—many of which were summarily rejected below—in a transparent effort to direct this Court's attention away from the issues raised by the Government on this appeal and from the facts that (i) the defendants have not been prejudiced in any way in this criminal case (ii) a more than adequate alternative

remedy is available in the form of relieving the defendants from their remaining civil liabilities, and (iii) the Grand Jury and the United States Attorney's Office were uninvolved in and unaided by any SEC misconduct.

In particular, the defendants' tactic of spreading confusion is aimed at avoiding the District Court's express finding that the SEC's obligation to advise the defendants of the criminal reference arose only *after* the reference had already been made. This finding, together with the undisputed fact that the defendants did not rely in any manner detrimental to their rights as accused on the SEC's failure to advise them of the reference, makes it clear that this criminal case was not in any sense a fruit of the SEC's misconduct.

ARGUMENT

POINT I

Dismissal Of Charges In The Indictment Was Totally Unwarranted.

In a confusing and inaccurate presentation, defendants Fields and Friedman have attempted to create the impression that the determination of an appropriate remedy in this case is a matter of such factual complexity that it is best left to the seemingly unlimited and undefined discretion of the District Court.* In reality, however, the

* After asserting that the Government's statement of facts "omits highly relevant facts . . . and misstates and distorts other facts," and after "respectfully refer[ing] the Court to the [District Court's] findings" and assuming this Court's "[f]amiliarity with those factual findings," Fields and Friedman present their own eight page version of the facts. (Fields' Br. 3, 7-14). This version misrepresents "the relevant facts as found by the District Court." (Fields' Br. 7).

[Footnote continued on following page]

impropriety of the District Court's dismissal of criminal charges is a relatively straightforward question of law once the inquiry is properly focused on the factors governing the granting of equitable relief, that is, (1) whether the relief granted is remedial in nature, (2) whether the relief granted is consistent with the nature and scope of the violation, and (3) whether the defendants are barred from obtaining equitable relief because of "unclean hands." See *Milliken v. Bradley*, 45 U.S.L.W. 4873 (U.S., June 27, 1977), and other authorities cited in the Government's initial brief at 18-34.

A. The Government's Purported Concession and Waiver

Defendants Fields and Friedman argue that (1) by failing to propose it on appeal, the Government has conceded that the remedy we suggested in the District Court—vacatur of the civil consent judgments—is inadequate, and that (2) the Government has waived the remedy proposed on this appeal—modification of the civil consent judgments—by failing to urge it below. These contentions ignore the obvious fact that the remedy proposed on this appeal was plainly included within the remedy suggested to the District Court. Thus, the Government has not abandoned vacatur of the judgments as inadequate. Rather, after analyzing the specific findings of the District Court, we concluded that vacatur is an unnecessarily broad remedy, and that modification of the

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For example, the defendants assert that the District Court found that Mr. Kantor, TDA's general counsel, reported to the board of directors that "on June 17, 1975, a member of the SEC staff had informed him . . . that his staff would not refer the matter for criminal prosecution." (Fields' Br. 8). Yet the District Court's opinion contains no mention of this "fact" which it supposedly found. The defendants neglect to mention as well that, on cross-examination, Kantor admitted that his report to the board of directors was based on his own assumption and not on any such statement by anyone from the SEC. (App. 431-43).

consent decrees would most closely comply with the rules governing equitable relief established by the Supreme Court.* It is also impossible to comprehend how the failure specifically to propose a modification of the consent decrees below could operate as a waiver. Once the Government demonstrated that the defendants suffered no prejudice whatsoever in this criminal case in consequence of the SEC's misconduct, and that appropriate relief was available in the civil context, the District Court could have granted relief in the civil case in an infinite number of ways, ranging from complete vacatur of the consent decrees to only slight modification. Any remedy from that range of possibilities would likely have been within the District Court's discretion. It is preposterous to suggest that, by failing specifically to propose each of the infinite number of possible remedies within this range, the Government somehow waived its right to suggest one of those possibilities.

B. The District Court's Remedy Was Improper As a Matter of Law

The defendants' attempt to support the dismissal of criminal charges herein by reference to other cases in which dismissal was obtained (Fields' Br. 36-39; Davis Br. 16-19) serves merely to emphasize the correctness of the Government's position. Each of the cases cited in their briefs involved misconduct by the prosecutor himself, *e.g.*, *United States v. Litton Systems, Inc.*, Crim. No. 77-70-A (E.D. Va. May 25, 1977), or serious prejudice to the defendant in his criminal case, *e.g.*, *United States v. Toscanino*, 500 F.2d 267 (2d Cir. 1974), or both, *e.g.*, *United States v. Jacobs*, 547 F.2d 722 (2d Cir.

* While modification of the consent judgments would be the most appropriate remedy, we do not object to complete vacatur, to which the SEC has already expressly consented. (App. 128).

1976), *cert. granted*, — U.S. —, 45 U.S.L.W. 3777 (1977); *United States v. Minnesota Mining & Manufacturing Co.*, 551 F.2d 1106 (8th Cir. 1977); *United States v. DeMarco*, 401 F. Supp. 505 (C.D. Cal. 1975).^{*} Dismissal of criminal charges where both of these elements are lacking is thus indeed wholly “unprecedented.”

While the defendants desperately desire to bring themselves within the four corners of *United States v. Rodman*, 519 F.2d 1058 (1st Cir. 1975),^{**} that case is inapposite since, in *Rodman*, the indictment was dismissed because the SEC breached its express agreement to “strongly recommend” against prosecution.^{***} Here, the District Court found that there was no agreement, and that the SEC’s obligation to advise the defendants of the criminal reference arose only *after* the reference had already been made. Thus, armed with knowledge of the criminal reference, the defendants could have done no more in this criminal case than what they actually did, that is, attempt to persuade the United States Attorney not to indict.

^{*} The suggestion in Fields’ Br. 40, n.24, that the United States Attorney’s Office “did in fact follow the [SEC’s] request” to delay proceeding against TDA until the civil case was “wrapped up” is totally false. As the record amply reveals, the SEC made no such request, and the delay in the presentation of the case to the grand jury was not a matter of design but resulted solely from the fact that, because of a heavy work load, there was simply no one in the United States Attorney’s Office who was free to work on the case at that time. (Tr. 645, 1329-30, 1361-63).

^{**} Indeed, this one page *per curiam* decision—in which none of the issues raised on this appeal was even considered—has become virtually the cornerstone of the defendants’ position. (See, Fields’ Br. 15, 16, 19, 20, 21, 41, 44; Davis’ Br. 14, 16, 18, 19, 20, 21).

^{***} If the SEC had kept its promise in *Rodman* to “strongly recommend” against prosecution, the United States Attorney might not have sought an indictment. The defendants here do not, and cannot, claim any such promise.

Moreover, in *Rodman*, the defendant made extensive incriminating admissions in reliance on the SEC's express promise. In contrast, the defendants here asserted the Fifth Amendment.

Equally unconvincing is the defendants' argument that, even though the District Court's remedy may have been incorrect, it was not beyond the pale of the District Court's "discretion." The District Court plainly does not have discretion to grant remedies that are not remedial. The defendants' ritual incantation of the familiar "abuse of discretion" refrain cannot restrict this Court's *de novo* review of remedies which bear no relationship whatever to any prejudice suffered by the defendants. This is particularly so here where the public interest in criminal prosecution is so dramatically frustrated. When the District Court crossed the line into dismissing criminal charges as a form of equitable relief—relief which was unrelated to any prejudice suffered—it granted a remedy wholly unsupported by the facts or by precedent. As the Supreme Court has repeatedly found, equitable relief is subject to *de novo* review on appeal. *E.g.*, *Milliken v. Bradley*, *supra*, 45 U.S.L.W. at 4877; *Milliken v. Bradley*, 418 U.S. 717, 744-47 (1974), and other cases cited in the Government's initial brief at 18.

The defendants' effort (Fields Br. 40-42; Davis Br. 19-20) to portray the SEC as, in effect, "an arm of the prosecutor" in this case is similarly unsuccessful. While this defense contention has little merit as a general matter (see Government's initial brief at 28-30), the specific facts of this case make it perfectly clear that the United States Attorney and the Grand Jury do not bear responsibility for the SEC's conduct. First, the SEC's action was taken without the knowledge or consent of the United States Attorney's Office. Second, the United States Attorney and the Grand Jury did not profit in any way from the misconduct. Finally, the SEC's action was

aimed at fostering a civil settlement, and was not designed to aid the prosecution. Thus, the deterrent effect of the District Court's order was totally misdirected because the civil settlement was left intact and the wrong parties were punished. The District Court could have accomplished more effective deterrence by punishing the SEC in the context of its own civil proceedings.

Finally, the defendants' efforts (Fields Br. 46-49) to avoid the clear mandate of the "unclean hands" doctrine is also unavailing. While purporting to demonstrate the correctness of the District Court's decision—which specifically held that there was no agreement—the defendants argue that the "Zammas manipulation came to the attention of the United States Attorney's Office and the grand jury solely and directly as a result of the SEC's breach of its agreement not to make a criminal reference." (Fields' Br. 48). The defendants' argument is thus plainly wrong, and fails to answer our point that, in all their negotiations with the SEC, the defendants never disclosed this aspect of their criminal activities and thus were hardly more candid than the SEC in the maneuvering to obtain a settlement of the civil case.*

* Defendants also complain (Fields' Br. 47, n.29) that they were unfairly and falsely "blacken[ed]" by the Government's reference to their willingness to employ threats of violence to serve their criminal purposes. Actually, this fact was essential to explain the dangers and problems inherent in any procedure involving SEC disclosure of its criminal references. (Of course, we do not contend that the SEC's attorneys have any right to mislead defense counsel; obviously they can avoid any problem by advising defense counsel that the SEC makes no commitment one way or the other regarding a criminal reference, and that counsel should contact the United States Attorney regarding the possibility of criminal prosecution.) Moreover, contrary to their assertion, defense counsel are well aware of the threat made by defendant Fields and his gun-carrying "friend," Quido Benigno, since that incident was secretly recorded and the tape and transcript were long ago made available to counsel. (Benigno is presently serving

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C. The Defendants Have Suffered Absolutely No Prejudice as Criminal Defendants and Minimal Prejudice as Civil Litigants

Defendants have suffered no prejudice of any kind to their rights as accused. Indeed, they do not suggest any such prejudice. In an attempt to avoid the clear mandate of the Supreme Court that a criminal defendant is not entitled to relief from violations of his rights as an accused disproportionate to the prejudice suffered in his criminal case, *e.g.*, *Weatherford v. Bursey*, 429 U.S. 545 (1977); *United States v. Agurs*, 427 U.S. 97 (1976); *Hampton v. United States*, 425 U.S. 484 (1976); *United States v. Russell*, 411 U.S. 423 (1973); *Giglio v. United States*, 405 U.S. 150 (1975), the defendants have instead focused on the civil judgments to which they consented, and have sought to portray the civil and administrative relief obtained against them as extremely onerous.

While the existence of civil prejudice to the defendants is essentially irrelevant to the validity of this Indictment, the facts that (i) the civil relief obtained against the defendants was not onerous at all, and that (ii) the Government's proposed modification of the consent decrees would leave them in a position better than any they could have hoped to achieve (see Government's initial brief at 22-25), serve to underscore the impropriety of dismissing criminal charges in this case.

The defendants' effort to establish that they suffered an irreparable harm in their civil case is plainly ineffectual and grossly misleading. For example, Fields and Friedman protest at length the Government's demonstration that they received direct remuneration in fiscal 1976 of

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an 18 month sentence in *United States v. Brown, et al.*, 555 F.2d 336 (2d Cir. 1977) for his involvement in a \$1.4 million counterfeited securities scheme.) The tape and transcript are, of course, available to this Court, if desired.

\$233,630 and \$170,412 respectively, representing increases of \$89,150 and \$68,412 over fiscal 1975, which increases were more than sufficient to reimburse them for the \$60,000 they were obligated to pay on January 2, 1977 under the consent judgments. While it is true, as these defendants contend, that their "one time" retroactive "cost of living" increase is said to apply to the three-year period ending June 30, 1975 (Fields' Br. 30), it is irrefutable that this increase was voted by TDA's board of directors and paid to the defendants in the fiscal year ended June 30, 1976, many months after the defendants had acknowledged that they would make restitution. Moreover, the Form 10-Ks (annual reports) for fiscal 1977 filed with the SEC on October 4, 1977 by TDA and by Westcalind reflect that Fields and Friedman remain among the highest paid executives in the United States who have admitted defrauding their own companies. Indeed, they have again augmented their compensation to keep pace with the "onerous" burdens of the consent judgment.* Thus, regardless of whether they could have otherwise obtained these increases (and their bonuses) or not, the overall financial terms of the settlement can hardly be characterized as burdensome to these defendants.

*	<i>Fields</i>		<i>Friedman</i>	
	Fiscal 1976	Fiscal 1977	Fiscal 1976	Fiscal 1977
Salary from TDA	\$139,437	\$148,765	\$ 78,552	\$ 84,130
Retroactive increase from TDA	36,860	—	36,860	—
Bonus from TDA	25,000	40,000	25,000	40,000
Salary from Westcalind	20,333	100,500	18,000	60,000
Fee for "management services" from Westcalind	12,000	12,000	12,000	12,000
TOTALS:	\$233,630	\$301,265	\$170,412	\$196,130

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Defendants Fields, Friedman, and Davis also have the audacity to complain that they were unfairly required to repay the \$585,000 fraudulently obtained from TDA, Westcalind, and a group of TDA shareholders because they did not personally pocket all of the proceeds of their fraud. The fraudulent stock scheme, in which ERD was cheated out of \$435,000, was designed, financed, and set in motion by the defendants, based on the secret understanding that the defendants' nominee, Bernardi, would kick back 70% of the gross profits to the defendants. Thus, the defendants arranged for a TDA subsidiary to loan defendant Davis \$100,000, which amount was paid to ERD as Bernardi's down payment on the stock purchase. Subsequently, Bernardi refused to turn over the defendants' full 70% share, which refusal later led to threats of violence by the defendants. (See footnote *supra* at 7). As to the two phony "finder's fee" transactions which yielded \$150,000 at the expense of TDA and Westcalind, the defendants paid a total of \$33,000 to their accomplices. Thus, while the defendants did not put in their own

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It should be noted as well that Westcalind—which paid total compensation to Fields and Friedman of \$184,500 in fiscal 1977—had a net income of only \$72,761 from gross revenues of \$2,277,289.

Defendant Fields has submitted evidence to this Court that, subsequent to the District Court's decision, he paid all of his remaining monetary liability, and argues that modification or vacatur of the civil judgment would not provide him with any relief. Putting aside the question of whether this payment was made for strategic purposes, the corporations have already reimbursed Fields. [The Forms 10-K for fiscal 1977 were filed with the SEC on October 4, 1977 and accordingly were unavailable to offer in the District Court. The District Court did receive in evidence the Forms 10K for fiscal 1975 and fiscal 1976, which forms were included in the record on appeal by stipulation (see GX 23 and GX 24). The Government requests the Court to take judicial notice of the forms for fiscal 1977. Rule 201(b), Fed.R. Evid.]

pockets 100% of the moneys fraudulently obtained by them, it is hornbook law that the defendants are responsible—both criminally and civilly—for the total amount obtained in these illegal and fraudulent schemes.

Defendant Davis also makes the absurd suggestion that his right to practice law before the SEC would not have been in jeopardy if he had received prompt warning of the criminal reference. Yet his own counsel foresaw from the very outset that Davis' legal career was at an end. (App. 564). Indeed, counsel never even sought to negotiate a lesser administrative sanction. (App. 46, 49, 51, 52, 54, 56, 564). As discussed more fully in the Government's initial brief at 27, it stretches credulity too far to suggest that Davis could have preserved his right to practice before the SEC after admitting to the SEC through his attorneys corrupt and unethical behavior of gross proportions—an admission that was made prior to any negotiations whatsoever between the defendants and the SEC. Moreover, since Davis could not have prevented a criminal prosecution even if he had received prompt notice of the criminal reference,* his membership in the Bar was clearly at stake. *Matter of Chu*, Dkt. No. 483 (N.Y., October 13, 1977); *Matter of Cahn*, Dkt. No. — (App. Div. 2d Dept., October 24, 1977).

* All defendants in the case were provided with a full hearing with the Assistant in charge of the case, the Chief of the Criminal Division, and the United States Attorney, prior to the filing of the Indictment. (Tr. 1187-88).

POINT II

As The District Court Found, There Was No Agreement Of Any Kind Between The SEC And The Defendants.

In Point I of their brief, defendants Fields and Friedman ask this Court to resurrect their theory that the dealings between defense counsel and the SEC attorneys in the civil case somehow constituted an agreement that the SEC would make no criminal reference.* The District Court specifically found that "there was no *express* agreement, as to any of the present defendants" (emphasis in original) (App. 62), and this finding was amply supported by the evidence.

Indeed, the defendants' lawyers never even attempted to obtain such an agreement from the SEC. While it would have been simple and prudent for defense counsel to have requested a written commitment from the SEC,

* This theory is not even properly before this Court. While it is accurate, as the defendants contend, that an appellee may urge additional grounds for affirming an order of a lower court; an appellee may *not* assert, absent a cross-appeal, any such additional ground, the logical consequence of which would entitle him to relief beyond what he obtained in the lower court, even if he is not seeking the extra relief. *Mills v. Electric Auto-Lite*, 396 U.S. 375, 381, n.4 (1970); *NLRB v. Express Publishing Co.*, 312 U.S. 426, 431-32 (1941); see also, *Strunk v. United States*, 412 U.S. 434, 437 (1972); *NLRB v. International Van Lines*, 409 U.S. 48, 52, n.4 (1972). Here, under the defendants' theory, the SEC's breach of the purported "implied agreement" would entitle them to dismissal of the entire Indictment, not simply those portions which are the subject of the Government's appeal. Since the defendants are not entitled to cross-appeal, *United States v. Swarovski*, 557 F.2d 40, 49 (2d Cir. 1977), and in any event they did not attempt to do so, their "implied agreement" theory cannot be raised on this interlocutory appeal.

as did other defense counsel in this very case,* counsel did not even take the minimal step of seeking an oral understanding. Not one of the several experienced defense counsel in the case ever bothered to ask in words or substance: "Will the SEC agree not to make a criminal reference?" To the contrary, experienced counsel and the defendants all signed a consent to final judgment expressly denying the existence of any such agreement or understanding:

"This consent is given by defendants Fields, Friedman and Davis voluntarily and no promise or threat of any kind whatsoever has been made by plaintiff Commission or any member, officer, agent, or representative thereof to induce Fields, Friedman, and Davis to enter into this consent." (App. 159, 197, 203-04).**

Stripped of all of the abstract legal theory about implied contracts, the defendants' position is a bald attempt to shift to the SEC the burden of proclaiming the non-existence of an alleged agreement upon which the defendants would like to rely, but as to which they never sought the SEC's assent. The District Court properly

* The District Court found that the situation of the defendants "may be contrasted with the cases of *Kreisler* and *Weston*, two individuals on the periphery of the transactions in question. Their counsel obtained, in consideration of their testimony to the SEC, specific [written] assurances by the SEC attorneys that they would recommend that neither *Kreisler* nor *Weston* be named in the civil action or in any criminal reference which might arise out of the pertinent transactions." (emphasis in original) (App. 62-63; GX 17, GX 18).

** The District Court accepted the defendants' assertion that this proviso, in the only written document evidencing the defendants' understanding with the SEC, should be totally ignored and dismissed because it was mere "boilerplate" which appears in virtually all consents to judgment. The District Court's conclusion is tantamount to saying, for example, that the same kind of statement which is required of the defendant in every guilty plea taken pursuant to Rule 11, Fed.R. Crim.P., is meaningless "boilerplate."

found that defense counsels' purported reliance on the silence of the SEC as signifying assent to an agreement was unreasonable (App. 65) and that there was no evidence to support the ridiculous defense contention that "silence is part of the professional communion that goes on between [defense counsel and the SEC]." (Tr. 28, see App. 66).*

The reasons for the defendants' discomfort with the District Court's decisional basis and for their attempt to revive their "implied agreement" theory are easy to discern.** First, it is clear from the District Court's find-

* In view of the lead defense counsel's testimony that he recognized at the outset that "this was a serious case . . . in plain language, a case of stealing" (App. 351-52), the District Court's findings were particularly apt:

"Experienced defense counsel are, perforce, aware that in cases of this nature, 'more than civil proceedings might be contemplated', *United States v. Parrott, supra*, 425 F.2d at 976. In these circumstances, if they wish to condition their clients' participation or cooperation in a civil proceeding, conducted by the SEC, upon an agreement by the SEC not to make a criminal reference, it is the obligation of counsel to make that specific request, and then be guided by the SEC's response to it. That is precisely the procedure followed by counsel for Messrs. Kreisler and Weston in this very case. In the Court's opinion, the burden of requesting and obtaining an express agreement from the SEC, in cases of this nature, falls reasonably upon the shoulders of defense counsel; and it follows that defense counsel cannot reasonably equate silence on the part of the SEC with assent." (App. 65-66).

** Presenting their "implied agreement" theory also provides the defendants with a convenient excuse for discussing in great detail the findings of the District Court, which are not in dispute on this appeal. In view of the defendants' repeated statements regarding the Government's acceptance of these findings, we feel it appropriate to note that we accept the District Court's findings *only* in the sense that we recognize that they are supported by sufficient evidence and therefore are not subject to attack on appeal. We do, however, completely disagree with the findings. Every SEC attorney who testified—Regional Admin-

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ings that the SEC misconduct did not cause the defendants any prejudice in the criminal case, nor was the criminal case itself a product of any misconduct, since the SEC's obligation to advise defendants of the criminal reference arose only *after* the reference had already been made and the Grand Jury was in no way aided by the SEC's misconduct. (App. 70-72). Accordingly, the defendants can only properly argue prejudice if the criminal reference was in breach of a prior agreement between the

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istrator William Moran, Associate Regional Administrator Donald Malawsky, Assistant Regional Administrators Jeffrey Tucker and William Nortman, and Branch Chief Stuart Perlmutter—specifically disputed the claims of defense counsel that counsel had stated that they were seeking to avoid a criminal reference, and denied that counsel had stated that they understood that there would be no criminal reference. In addition, Tucker and Perlmutter testified that Tucker advised defense counsel that “there is no deal on criminal.” (App.571, 657). Tucker and Perlmutter also disputed the testimony of attorney Gordon who said that Perlmutter had advised him that there would be no criminal reference. (App. 575; Tr. 1462). Thus, while we concede that it was within the province of the District Court to credit the testimony of defense counsel that they had been misled by Tucker and Perlmutter, we do not agree with the findings in the slightest.

In addition, and wholly apart from any specific issue of credibility, the overall scenario found by the District Court is improbable to the point of being fantastic. The District Court found, in essence, that the immensely experienced attorneys representing the defendants engaged in detailed negotiations over a period of months in which their principal “objective” was to avoid a criminal reference, but nonetheless left the resolution of this “objective” entirely to an unexpressed “understanding” and, in addition, allowed their clients to sign a specific acknowledgment that no promises had been made! When one adds to this the undisputed fact that not one of the defendants ever approached the United States Attorney to seek a definitive disposition of his “objective” from the only person empowered to make one, the ultimate factual conclusions of the District Court—while short of being “clearly erroneous”—are dubious in the extreme.

defendants and the SEC.* Then—and only then—can they contend that the Indictment itself is the product of a breached promise.

The second reason for the defendants' discomfort with the District Court's finding that there was no agreement is of course that this finding prevents them from securing any support from the *Rodman* case, on which they place great reliance. See discussion *supra* at 5-6.

While the defendants, alternatively, maintain that no showing of prejudice in the criminal case need be demonstrated to justify dismissal of the Indictment (and they criticize the Government for failing to cite *Matter of Doe*, 410 F. Supp. 1163 (E.D. Mich. 1976)), none of them points to a single case supporting dismissal of criminal charges where the misconduct of a government agency has no effect at all on the defendant's rights as an accused.** The remaining cases cited by the defendants

* Contrary to the defendants' assertion (Fields' Br. 15), the Government has *not* "retreated from the suggestion . . . that the case 'might have' reached the United States Attorney's Office through some other means." While the United States Attorney's Office in fact learned of the case from the SEC, it simply does not follow that, had the SEC agreed not to make a reference, the United States Attorney's Office would have been prevented from learning of the case through newspapers, advance sheets, or other sources. (Tr. 1284). Indeed, it is not at all uncommon for the United States Attorney's Office to request access to files which the SEC does not refer. (Tr. 1285).

** In *Matter of Doe*, *supra*, there were no criminal charges. That decision merely prevented the Government from compelling testimony from a witness about some contraband he had surrendered to the BNDD on the ground that government agents had induced the witness to surrender it by an express promise that the witness would not be questioned about the matter. Additionally, the witness claimed that giving testimony would endanger his life, and the court noted that "potential harm to the witness may be relevant where, as here, the witness and the government bargain beforehand to be excused from giving testimony." 410 F. Supp. at 1166. Thus, there was an element of prejudice even in that case.

Fields and Friedman (Fields' Br. 16-18) in fact support the Government, since the defendant in each of those cases suffered direct prejudice to his rights as an accused.

POINT III

The Criminal Reference Was Proper.

Defendant Sandberg presents the argument that only the SEC Commissioners have the authority to refer a case to the Department of Justice for criminal prosecution. From this premise, he argues that the failure of the New York Regional Office to obtain prior approval from the Commissioners to refer this case to the United States Attorney's Office justifies dismissal of the Indictment.*

This argument is without any merit. First, as the District Court determined, the governing rules do not prohibit the so-called "informal" criminal reference attacked by Sandberg. Second, these rules do not confer any benefits on criminal defendants, nor do they limit in any way the grand jury's broad powers to investigate and to indict.

The District Court disposed of defendant Sandberg's contentions as follows:

"In the case at bar, it is undisputed that the criminal reference took the form of an informal advice from Tucker of the SEC to Wing of the United States Attorney's Office. This informal procedure has grown up over the past several years, so that it now represents the manner in which most criminal references are made, at least

* This argument is also not properly before the Court at this time. See footnote *supra* at 12.

in this district. I am asked to declare this informal procedure illegal, and dismiss the indictment on that ground alone.

I decline to invalidate the working relationship which has grown up between the SEC regional offices and the offices of United States Attorneys in recent years. As explained in the evidence of Mr. Sporkin, the Chief of the SEC Division of Enforcement, the informal procedure is time-saving and the result of various practical considerations. Nothing in the statute or regulations expressly prohibits any method of criminal reference other than a reference by the Commissioners themselves; accordingly prohibition must be found, if at all, by necessary implication. But I conclude that the SEC may, without violating its governing statutes or its own regulations and procedures, sanction this method of informal criminal references. There are sufficient due process safeguards in the grand jury machinery itself, and defendants such as those involved in the present case are not legally entitled to insist that the SEC restrict itself to one particular procedure, even though that procedure, if followed, might have given defendants opportunities to urge, at an administrative level, that no criminal reference be made. Compare *SEC v. National Student Marketing Corp.*, 538 F.2d 404, 407 (D.C. Cir. 1976), *cert. denied*, — U.S. — (1977).” (App. 68-69).

The so-called “formal” criminal reference procedure—which defendant Sandberg would have this Court make mandatory—has been largely abandoned in recent years. The advantages of the “informal” reference to the SEC, to the United States Attorney, and to the administration of justice, are overwhelmingly clear. The informal reference avoids burdensome and time-consuming procedures at the SEC, including the preparation of a detailed report and a review at various levels (Regional Office,

Division of Enforcement, Commission). Such procedures are, on the one hand, wasteful of the SEC's resources in cases where the United States Attorney is not interested in proceeding with the case because the evidence or lack thereof does not warrant prosecution, or because his office is too busy with other cases.* On the other hand, in cases where prosecution is warranted and can be undertaken, review at the SEC serves only to put off the day when the defendants must defend on the merits, even to the extent of jeopardizing prosecutions because of the statute of limitations. (See Tr. 1302). Obviously, such delay is not in the interest of the Government, the defendant, or the Court.

Moreover, eliminating the lengthy review at the SEC does not deny a defendant any significant benefit conferred by our criminal justice system. After a criminal reference is made, the United States Attorney's Office must first decide whether or not to investigate the case. Then, if it does investigate, it must decide whether or not to present the case to a grand jury. Finally, the grand jury must decide whether or not to vote an indictment. In addition, the United States Attorney, at least in this District, as a matter of policy provides defendants in SEC cases with an opportunity to be heard before an indictment is filed. (Tr. 1199-1200). Notice of the presentment to the Grand Jury and a hearing with the United States Attorney were afforded the defendants in

* In *SEC v. National Student Marketing Corporation*, 538 F.2d 404, 407 (D.C. Cir. 1976), *cert. denied sub nom. White & Case v. SEC*, 429 U.S. 1073 (1977), relied upon by the District Court, the Court of Appeals for the District of Columbia Circuit rejected the defendants' claim that the SEC should have given them notice and an opportunity to present arguments as to why they should not have been sued by the SEC. The court stated that "[m]andating such a procedure would seriously burden the Commission's enforcement procedure, already characterized by adequate due process standards." These observations must obviously apply *a fortiori* to decisions to refer a matter to another agency.

this case. (Tr. 1188). Finally, of course, the defendant enjoys the ultimate presumption of innocence at trial, where the Government must prove his guilt beyond a reasonable doubt. Thus, there are ample safeguards against unwarranted prosecutions without introducing additional time-consuming and burdensome procedures at the SEC.

Even assuming *arguendo* a deviation from settled procedures, this would not be a basis for dismissing an indictment. *United States v. Stofsky*, 527 F.2d 237, 249 (2d Cir. 1975), *cert. denied*, 425 U.S. 902 (1976). In *Stofsky*, this Court stated:

"The failure of the government to afford [defendants] an administrative conference with the IRS [pursuant to an IRS regulation] before indictment did not nullify the grand jury's actions. The grand jury's broad powers to investigate and to indict . . . are not conditioned upon the taxpayers being given an opportunity to explain their conduct to a government official any more than to the grand jury itself."

Finally, any deviation was a matter of form, not substance. The initial transmittal of information about the case on December 1, 1975 consisted of the SEC's civil complaint and motion papers. Since these papers were matters of public record on file in the United States District Court, there were no rules whatever governing their "disclosure." * Following the December 1, 1975 trans-

* It is clear beyond question from the SEC regulations governing disclosure of its investigative files, and from common sense, that such regulations apply only to non-public records and information. See, *e.g.*, 17 C.F.R. § 240.04 (investigative informant is confidential "unless made a matter of public record"); Section 171.01, SEC Manual of Administrative Regulations (regulation concerning disclosure of investigative information "or any other non-public records").

mittal, the SEC's files were requested by, and provided to, the United States Attorney's Office in the spring of 1976. Commission approval was subsequently granted on April 25, 1977, and would have been routinely given whenever requested. (Tr. 1301).

POINT IV

The ERD Kickbacks Should Be Reinstated In Counts One, Two, And Three, Since They Should Have Been Disclosed In TDA's Prospectus.

In providing alternative grounds for striking portions of the Indictment, the District Court concluded that the ERD kickbacks were not required to be disclosed in the TDA prospectus because they "did not in any discernible way bear upon the financial condition of the company. . . ." (App. 85). The Government argued in its initial brief at 35-41 that (1) the District Court applied an incorrect standard of "materiality" and (2) the District Court's incorrect standard was satisfied in any event.

In response to the Government's position, the defendants have engaged in a rambling argument, full of speculation and inaccuracies, in yet another effort to avoid the sole issue presented in this portion of the appeal: were the ERD kickbacks "material" to potential investors and purchasers of stock on the TDA public offering? Defendants thus devote a good deal of space to their assertion that the charges here are based on "a procedural gimmick." (Fields Br. 50). But the charges here are virtually identical to those sustained in numerous securities fraud prosecutions. *E.g.*, *United States v. Aloï*, 511 F.2d 585 (2d Cir. 1975); *United States v. Koss*, 506 F.2d 1103 (2d Cir. 1974), *cert. denied*, 421 U.S. 911 (1975); *United States v. Fishbein*, 446 F.2d 1201 (9th Cir. 1971), *cert. denied*, 404 U.S. 1019 (1972). Indeed,

the defendants do not contest the validity of those portions of the charge—upheld by the District Court—that they should have disclosed the Westcalind kickback in the prospectus. Plainly, the question is not whether the allegations pertaining to the ERD kickbacks constitute a “gimmick,” but whether the kickbacks were “material.”

On the merits of the only issue truly before this Court, the “materiality” of the ERD kickbacks, neither the District Court nor the defendants have cited a single authority supporting the District Court’s restrictive definition of materiality. Indeed, the defendants do not even attempt to deal with the controlling definition set forth by the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976). Moreover, they are unable to distinguish the cases cited by the Government as examples of situations where courts have found material omissions which did not bear on the issuer’s financial condition. The fact that these cases also involve other material omissions that did bear on the company’s financial condition in no way obviates the rulings that the omissions not bearing on the issuer’s financial condition were material.

The defendants next dispute that the ERD kickbacks were uncollected assets of TDA under § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). This contention has no merit. While it is true that title to the stock was in the name of the defendants’ nominee, Bernardi, the defendants were the beneficial owners. They financed the stock purchases from ERD by causing a TDA subsidiary to loan \$100,000 to defendant Davis, who in turn gave the \$100,000 to ERD as Bernardi’s down payment. In addition, the defendants were to receive 70% of the gross profits, leaving Bernardi only 30% for his trouble and for the payment of taxes on the entire amount of profit. At a minimum, therefore, defendants were accountable to TDA for 70% of the profits. *Whiting v. Dow Chemical Company*, 523 F.2d 680, 689

(2d Cir. 1975). Thus, defendants Fields and Friedman clearly exploited their corporate positions and threatened "the goal of the Securities Exchange Act to 'insure the maintenance of fair and honest markets.'" *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 591-92 (1973).

Finally, the fact that the SEC, as a part of the settlement of a lawsuit, agreed that Fields and Friedman could continue as officers of TDA is a far different matter from the right of investors and potential investors to know of the defendants' misdeeds and to be able to consider the implications of such misdeeds. The consent decree is therefore not, as the defendants blithely contend, a "refutation" of the Government' argument.

POINT V

Count Four Should Be Reinstated. The Transaction Caused By The Defendants' Misleading Proxy Statement Was The Election Of A Corrupt Director.

In dismissing Count Four on alternative grounds, the District Court concluded that the Westcalind and ERD kickbacks did not have to be disclosed in TDA's proxy statement distributed in December 1971. In the Government's initial brief at 41-48, we pointed out that the District Court ignored specific proxy rules requiring that such activities be disclosed in the company's proxy statement. These rules were designed to provide stockholders with material information relating to one of their most important rights—the election of corporate directors. In the instant case, the defendants of course were not seeking authority by proxy to engage in the Westcalind and ERD kickbacks schemes. They were, however, seeking the re-election of a corrupt director, defendant Friedman.

The defendants' argument (Fields' Br. 62-69; Davis' Br. 28-36) as to the alleged lack of "transaction causation" thus totally misses the point. The "transaction caused" was the election of a corrupt director.* Indeed, the District Court clearly recognized this in sustaining Count Five:

"Where individuals present themselves for election as directors of a corporation, and fail to disclose in proxy solicitations that they have, in effect, been stealing from the very corporation which they desire to continue to 'serve', the necessary element of 'transaction causation' is present, and a violation of Section 14(a) arises. To hold otherwise would make a mockery of the proxy statute and regulations." (App. 95).

On this basis, the District Court concluded that the Westcalind kickback should have been disclosed to Westcalind shareholders in connection with the proposed election of certain of the defendants as Westcalind directors.

Thus, the sole issue on this appeal is whether or not the District Court erred in concluding that the Westcalind and ERD kickbacks were not material to TDA shareholders in connection with their election of corporate directors. The proxy rules—which the District Court did not even consider—make it clear that these kickbacks should have been disclosed.** (See Government's initial

* See *Rafal v. Geneen*, '72-'73 CCH Fed. Sec. L. Rptr. § 93, 505 at 92, 441 (E.D. Pa. 1972): "The election of these persons to the Board of Directors is clearly a 'transaction' for which stockholders' approval is sought within the context of § 14a. The election of a board of directors may be the most important, and in some cases the only, transaction in which the stockholder has any significant voice in determining the company's destiny."

** Defendants incorrectly claim that this point was not raised in the District Court. The authorities cited by the Government in support of Counts Four and Five specifically rely on the proxy rules. See Government's Memorandum of Law in Opposition to Defendants' Motions for Dismissal, Severance, and Change of Venue at 39.

brief at 45-46). Moreover, and wholly apart from the proxy rules which specifically call for such disclosure, the controlling standard of materiality enunciated by the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, *supra*, 426 U.S. at 449, plainly compels disclosure. It would be "a mockery of the proxy statute and regulations" to hold that a TDA shareholder would have seen no significance in the defendants' theft of \$435,000 from other TDA shareholders (the ERD group) or in the phony \$50,000 "finder's fee" paid by Westcalind for the defendants' personal benefit.

CONCLUSION

The order of the District Court striking paragraphs 10(d)-(h) and 11(e) and dismissing Counts Four through Eleven of the Indictment should be reversed, and the case should be remanded for trial.

Respectfully submitted,

ROBERT B. FISKE, JR.,
*United States Attorney for the
Southern District of New York,
Attorney for the United States
of America.*

DAVID A. CUTNER,
FREDERICK T. DAVIS,
LAWRENCE B. PEDOWITZ,
*Assistant United States Attorneys,
Of Counsel.*